Brief in Support of the Petition.

STATEMENT.

Statements regarding the opinions of the court below, the jurisdiction of this Court, the questions presented, and the errors assigned, will be found in the petition. The petition also contains a brief statement of the material facts.

SUMMARY OF THE ARGUMENT.

I. The scope of review by the Circuit Courts of Appeals following the adoption of the new rules should now be determined by this Court.

II. Section 12(2) of the Securities Act does not apply to brokers executing orders for their customers who purchase securities.

A. The petitioners are not "sellers" within the meaning of Section 12.

B. The respondent did not purchase the securities from the petitioners.

C. Section 12 contemplates rescission, impossible here.

D. Section 12 must be strictly construed.

I. THE SCOPE OF REVIEW BY THE CIRCUIT COURTS OF APPEALS FOLLOWING THE ADOPTION OF THE NEW RULES SHOULD NOW BE DETERMINED BY THIS COURT.

The Circuit Court of Appeals in affirming the judgment of the District Court did so upon a construction of Section 12(2) of the Securities Act imposing the liabilities of a seller upon a person acting as broker for the seller. The District Judge had made no finding to the effect that the petitioners had acted as brokers for the seller. The Circuit Court of Appeals, however, concluded from a short excerpt from Lynch's testimony (see Rec. pp. 127, 128, 302) that the

petitioners were acting as brokers for the seller. In other words, it, itself, made the focal finding upon which it affirmed the judgment below.* It could properly have done so only in the event that on the appeal the case was open *de novo* for the purpose of making findings not made by the District Judge.

Prior to the adoption of the new federal Rules of Civil Procedure, no possible justification could have been found for any such action by a Circuit Court of Appeals. If a law action can be open for new findings on appeal, it is only by virtue of the provisions of the new rules.

Except in so far as they may be abrogated by the new rules, trials of law cases in the District Court without the intervention of a jury and appeals from judgments in such cases are governed by the provisions of Title 28, U.S.C. §§ 773 and 875. Section 773 provides:

> "Issues of fact in civil cases in any district court may be tried and determined by the court, without the intervention of a jury, whenever the parties, or their attorneys of record, agree to waive a jury by a stipulation in writing filed with the clerk or by an oral stipulation made in open court and entered in the record. *The finding of the court upon the facts, which may be either general or special, shall have the same effect as the verdict of a jury.*"

*The Circuit Court of Appeals apparently gave no consideration to the documentary evidence. The petitioners' records clearly showed that they acted as brokers only for the respondent. Plaintiff's Exhibit 5a showed (at Rec. p. 257) the confirmation by the petitioners of the purchase from E. E. Smith & Co. for the account of the respondent, and at page 260 the confirmation of the sale by E. E. Smith & Co., which would not have been done had the petitioners been acting for E. E. Smith & Co. Similarly, Defendants' Exhibit C (Rec. p. 270) and Exhibit H (Rec. p. 275) showed the purchase of the securities for the account of the respondent. The respondent paid the petitioners a commission, and that was the only compensation which the petitioners received (Rec. p. 186).

Section 875 deals with review by the Circuit Court of Appeals in cases tried without a jury. This section provides:

> "When an issue of fact in any civil cause in a district court is tried and determined by the court without the intervention of a jury, according to section 773 of this title, the rulings of the court in the progress of the trial of the cause, if excepted to at the time, and duly presented by a bill of exceptions, may be reviewed upon a writ of error or upon appeal; *and when the finding is special the review may extend to the determination of the sufficiency of the facts found to support the judgment.*"

The only new rule which could possibly be deemed to amend these statutes by implication is Rule 52(a), entitled "Findings by the Court," and providing:

> "*Effect.* In all actions tried upon the facts without a jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court."

Of this the only part which is pertinent to the present case is the third sentence, reading:

> "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the oppor-

tunity of the trial court to judge of the credibility of the witnesses."

This sentence is an exact statement of the well-established rule of practice in equity by which appellate courts limit the exercise of their undoubted power to consider the evidence in equity cases on appeal *de novo*. By incorporating this sentence in Rule 52, was it intended to enlarge the powers of Circuit Courts of Appeals beyond what they had previously been?

The language of Rule 52 alone discloses no intention to make any such radical change of practice. Nowhere is it stated that the evidence shall be open for review *de novo* by the appellate court. A statement that a finding of fact shall not be set aside unless clearly erroneous is not an apt way of saying that the appellate court shall have untrammeled power to make findings of fact not made by the trial court. This is particularly true where such a provision would effect the supersession of a statute which has long been on the books.

The notes of the Advisory Committee with reference to this rule do not suggest that it effected any such radical change in the practice. In those notes it is stated:

> "The provisions of U.S.C. Title 28, §§773 . . . and 875 . . . are superseded in so far as they provide a different *method* of finding facts and a different *method* of appellate review. The rule stated in the third sentence of subsection (a) accords with the decisions on the scope of the review in modern federal equity practice. It is applicable to all classes of findings in cases tried without a jury. . . ."

This statement is clearly indicative that the committee did not intend a complete change in the practice. It will be observed that they do not say that Sections 773 and 875 are

superseded *in toto,* but that they are superseded only in so far as they provide for a different *method* of making findings and of appellate review. A complete change in the scope of permissible review is far more than a change which provides a "different method of appellate review." "Method" obviously refers to the taking of exceptions in court, the presentation of requests for findings, the filing of a bill of exceptions, assignments of error, and the like. These things have been changed and a statement that the "method of appellate review" has been changed is an apt reference to them. Moreover, unless the provisions in Sections 773 and 875 which are italicized above still remain in force, the sections would have been superseded *in toto.* If they do remain in force, as we contend, the Circuit Court of Appeals exceeded its power in making the additional finding of fact which it made.

The question has not been considered by this Court. This Court has, however, indicated the requirement that essential findings be made by the trier of fact even where issues of fact are open to review in the appellate court.

Ford Motor Co. v. *Nat'l Labor Relations Board,* 305 U.S. 364:

In that case the Circuit Court of Appeals had remanded the case to the Board with directions that it should, among other things, issue proposed findings of fact. In commenting upon this point this Court said:

> "It is familiar appellate practice to remand causes for further proceedings without deciding the merits, where justice demands that course in order that some defect in the record may be supplied. Such a remand may be made to permit further evidence to be taken or additional findings to be made upon essential points. So, when a District Court has not made findings in accordance with our controlling rule (Equity Rule 70½)

it is our practice to set aside the decree and remand the cause for further proceedings" (p. 373).

From this it is apparent that, even had the instant case been in equity, the practice approved by this Court would have required the Circuit Court of Appeals to send the case back to the District Court for a finding rather than to make one itself on the issue as to whose brokers the petitioners were.

We have found no case in which a Circuit Court of Appeals has stated that the facts are open *de novo* on appeals in law cases. The courts in all of the circuits except the second and fifth have had occasion to refer to Rule 52(a) in law cases, but none has rendered a decision which would support the action taken in the instant case. On the contrary, there is substantial authority contra.

The court for the Seventh Circuit has stated flatly that the rule does not open the evidence *de novo*.

Webb v. *Frisch*, 111 F. (2d) 887, 888:

"We do not understand that the foregoing rule has enlarged the discretion of this court in passing upon the probative force of evidence. Our function is to review the finding of the lower court and not to pass upon the evidence de novo. We cannot say that a finding of the fact of prior use is 'clearly erroneous' merely because we might have entertained some doubt about the quantum of evidence. We must attach to the testimony of witnesses the full weight and quality of credibility which the trial court gave it."

Knapp v. *United States*, 110 F. (2d) 420, 422:

"The question of law we are asked to decide is whether the finding of the trial court was based upon substantial evidence. We are not the triers of fact but merely the reviewers of the action of the triers and

limited in our investigation to an ascertainment of the existence of substantial evidence sufficient to support the finding, . . . and in the consideration of this question we must assume as established all the facts that the evidence reasonably tends to prove . . . and the finding should not be set aside unless clearly erroneous."

See also *In Re Duvall,* 103 F. (2d) 653:

That was a bankruptcy case and so presented a somewhat different situation, but the following statement in the opinion (at p. 655) is illuminating:

"The argument presented here indicates that counsel, erroneously, we think, have assumed that this is a trial de novo. Ordinarily, this court sits merely in the capacity of review and is bound by the finding of the lower court where the same is supported by substantial evidence, notwithstanding the fact that we might have reached a different conclusion on a matter submitted to us as an original proposition. This situation, applicable to reviewing courts generally, is due to the long recognized fact that the court who has seen and heard the testimony of witnesses is in a better position to judge of their credibility and the weight to be attached to their testimony, than is a reviewing court with nothing before it but the printed record."

In the Ninth Circuit one of the Circuit Judges has clearly indicated that in his opinion the facts are not open *de novo* in a civil action in the nature of an action at law.

Occidental Life Insurance Company v. *Thomas,* 107 F. (2d) 876:

Here a judgment for the plaintiff on an insurance policy was affirmed after a consideration of the evidence support-

ing the finding of the District Judge. In a concurring opinion, Circuit Judge Haney stated:

> "I believe that the conclusion of the majority is reached by weighing the evidence, and doubt that we have any such power. I think it was for the trial court to determine whether the weight of the evidence was for appellee, for appellant, or whether the evidence gave equal support to each of two inconsistent inferences within the rule announced in Pennsylvania R. Co. v. Chamberlain, 288 U.S. 333, 339, 53 S. Ct. 391, 77 L. Ed. 819. Questions as to the weight of the evidence are not to be decided by us. The only question before us is whether or not the finding of the trial court is clearly erroneous. Federal Rules of Civil Procedure, Rule 52(a). I think such finding is clearly erroneous only if no reasonable man could logically infer accidental death from the evidence. I believe it is apparent that reasonable men would differ in making inferences from the evidence before us, and therefore the finding is not clearly erroneous. For these reasons I think the judgment should be affirmed" (p. 879).

The Circuit Court of Appeals for the First Circuit has intimated that the latitude of review on the facts has been somewhat enlarged by Rule 52.

Manning v. *Gagne,* 108 F. (2d) 718:

It was there stated (at p. 719):

> "The trial was without jury, and in such cases, the 'substantial evidence' rule no longer applies. By virtue of the Federal Rules of Civil Procedure . . . the applicable test is whether having due regard to the opportunity of the trial court to judge of the credibility of witnesses the finding was 'clearly erroneous', Rule 52(a)."

This is the furthest that any court has gone, and in this there is no suggestion that the Circuit Court of Appeals is empowered to do more than set aside a finding of the District Judge if clearly erroneous, even though there may have been substantial evidence to support it. Even if this is good law, it would not justify the action of the court in the instant case. It is interesting to note that the court in the *Manning* case spoke through Judge McLellan, who dissented in the case at bar on the ground that there should have been a new trial.

It is pertinent in connection with the conclusion reached in the *Manning* case to consider a case from the Eighth Circuit.

Luzier's, Inc., v. *Nee*, 106 F. (2d) 130, 135:

> "It must be borne in mind that the court below was exercising the functions of a jury, and its findings are of the same force and effect as though the same were embodied in a jury's special verdict, 28 U.S.C.A. §773, and cannot be disturbed when there is substantial evidence tending to support the finding.
>
> "The trial court found that the tax involved herein was 'passed on' to the purchasers of the taxpayer's products. Were there some basis for concluding the contrary (we are of the opinion there is none), it is not within the province of this Court to re-examine the evidence and reverse this finding, unless the same is clearly wrong. It was the trial court's duty and right to determine the preponderating weight of the evidence. See United States v. Jefferson Electric Manufacturing Company, supra.
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> "This Court, in Brooks v. Willcuts, 8 Cir., 78 F. 2d 270, on page 273, expressed itself on the question in the quotation from Dooley v. Pease, 180 U.S. 126, page 131, 21 S. Ct. 329, 45 L. Ed. 457, as follows:

"'Where a case is tried by the court, a jury having been waived, its findings upon questions of fact are conclusive in the courts of review, it matters not how convincing the argument that upon the evidence the findings should have been different. Stanley v. Supervisors, 121 U.S. [535] 547, 7 S. Ct. 1234, 30 L. Ed. [1000] 1002.

"'Errors alleged in the findings of the court are not subject to revision by the circuit court of appeals, or by this court, if there was any evidence upon which such findings could be made [citing cases].'

"We are bound by this finding unless the same is clearly erroneous. Federal Rules of Civil Procedure, No. 52, 28 U.S.C.A. following section 723c; Collier v. Union Central Life Insurance Company, 5 Cir., 100 F. 2d 411; Guilford Const. Company, et al., v. Briggs, 4 Cir., 102 F. 2d 46."

The cases in the Eighth Circuit are of some interest, since that is the only court which has reversed the trial court on an issue of fact. It did so in

New York Life Insurance Company v. *Stoner*, 109 F. (2d) 874

and

State Farm Mutual Automobile Insurance Co. v. *Bonacci*, 111 F. (2d) 412.

Both of these cases were proceedings for declaratory judgments and it is not clear whether they were of equitable or of legal nature. In the *Bonacci* case, however, the court stated that Rule 52(a) "contemplates a review by the appellate court of the sufficiency of the evidence to sustain the findings" (p. 415). It made no suggestion that the evidence was open *de novo* for findings not made by the trial judge. In the *Stoner* case Judge Van Valkenburgh in his

concurring opinion pointed out that in the judgment of the court there was no room for disagreement as to the weight of the evidence, and went on to say:

> "It being the judgment of the majority that the evidence in favor of appellant leaves no disputed question for the trier of the facts, Rule 52 of the Rules of Civil Procedure is without application" (p. 884).

This is a clear suggestion that Rule 52 does not open the evidence to consideration *de novo*.

There are numerous other cases in which the courts have referred to the rule, but the references are not particularly illuminative either way.*

A radical change in practice accomplished through the implied repeal of ancient statutes by the promulgation of a new rule should require the opinion of this Court. The decision of the Circuit Court of Appeals, if it stands, how-

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Third Circuit:
Automobile Insurance Co. v. *Springfield Dyeing Co.*, 109 F. (2d) 533.
Fourth Circuit:
United States v. *One Hudson Coupe*, 110 F. (2d) 300.
Seventh Circuit:
United States v. *Borg-Warner Corp.*, 108 F. (2d) 424.
McDaniel v. *United States*, 108 F. (2d) 450.
United States v. *Anderson*, 108 F. (2d) 475.
Eighth Circuit:
Columbia Insurance Co. v. *Peoples Exchange Bank*, 109 F. (2d) 530.
Ninth Circuit:
Anglo California National Bank v. *Lazard*, 106 F. (2d) 693.
Maryland Casualty Company v. *Stark*, 109 F. (2d) 212.
Young v. *United States*, 111 F. (2d) 823.
Tenth Circuit:
American Home Fire Assurance Co. v. *Hargrove*, 109 F. (2d) 86.
Creel v. *Hudspeth*, 110 F. (2d) 762.
Pers v. *Hudspeth*, 110 F. (2d) 812.

ever, will constitute flat authority to the effect that in a law case tried without a jury the evidence is open *de novo* on appeal. The point is manifest from the dissenting opinion. This important point of practice was not argued in the instant case and has not been foreshadowed in any other case decided by any Circuit Court of Appeals. Other decisions, as we have seen, are in conflict. It is our contention that no such change in the practice has been accomplished by the promulgation of the new rules. Certainly the point is one which should be settled by this Court.

II. Section 12(2) of the Securities Act does not apply to brokers executing orders for their customers who purchase securities.

A. The petitioners are not "sellers" within the meaning of Section 12.

The respondent framed his declaration (Rec. pp. 2-4) on the theory that the petitioners owned the 1700 shares of South American Utilities and sold them to the respondent as principals. This would have given him a clear right of recovery under Section 12 of the Securities Act, but he was defeated in this attempt by the finding of the District Judge, already referred to, that the evidence was not sufficient to show that the petitioners owned the stock and sold it as principals (Rec. p. 290).

The evidence will support no other conclusion than that the petitioners were brokers who, after recommending the purchase of the shares in question, accepted and executed the respondent's order for the purchase of the shares. It is conceded that the judgment below may be supported if, and only if, a broker who accepts and executes an order for the purchase of securities is liable to his customer as a "seller" within the meaning of the Securities Act. This

was the only question presented on the record to the Circuit Court of Appeals, but this question that court did not decide at all.

Taking the narrow point presented on this record, we seek a construction of the applicable language of Section 12, which, omitting words here irrelevant, reads:

> "Any person who . . . sells a security . . . by means of an . . . oral communication, which includes an untrue statement of a material fact . . . and who shall not sustain the burden of proof that he did not know . . . of such untruth . . . shall be liable to the person purchasing such security from him, who may sue . . . to recover the consideration paid for such security . . . or for damages if he no longer owns the security."

The petitioners here contend that they are not within the meaning of the foregoing words "persons who sell a security," that the respondent did not purchase the security "from them," and that the respondent cannot recover from them the "*consideration*" paid for the security, because they never received it. As the respondent could not recover the consideration from them, there is no reason why he should recover damages.

Obviously the purpose of Section 12 was to put an end to the common-law doctrine of *caveat emptor*. The burden which the common law placed squarely on the shoulders of the buyer was lifted by the statute and placed just as squarely upon the shoulders of the seller. Under the statute the buyer need not beware, he may be as credulous as he choose—the seller, on the other hand, speaks at his peril. That, however, is as far as the statute goes. It is concerned only with the relationship between buyer and seller. It does not purport to say that any person who makes a mis-

representation concerning a security shall be liable to any other person who suffers loss as a consequence. It only says that a person who *sells* and misrepresents shall be liable to the person who *purchases from him.*

The relationship on which the liability depends is stated perfectly clearly and without the slightest ambiguity. The eligible defendant is defined as "any person who . . . *sells* a security" and the eligible plaintiff as "the person purchasing such security *from him.*" Persons occupying any other relationship could not qualify.

For example, suppose that a credulous investor purchases a security on the recommendation of a careless investment counsellor who has misstated the facts. The result may be that the investor loses his money, but he would have no cause of action under the statute. The investment counsellor did not sell the security (although he was the active cause of the purchase) and the investor did not purchase the security from him (although he did purchase because of him). The requisite relationship of seller and buyer could not exist. Whatever might be the situation at common law, liability under the express language of the Act could arise only on the passage of title from defendant to plaintiff.

So here, Rhoades & Company did not sell the 1700 shares of South American Utilities to Murphy. Murphy did not purchase it from them. Rhoades & Company did not receive the consideration for the shares.

The District Judge, however, although he found that there was no true sale, concluded that the definition of the word "sell" in Section 2 of the Act was so broad as to make Section 12 applicable even in the absence of the seller-buyer relationship (Rec. pp. 290, 291). The language of Section 2 which he relied on is:

> "The term 'sale', 'sell', 'offer to sell', or 'offer for sale' shall include every contract of sale or disposition

of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value."

From this he reasoned that, because Lynch had initiated the dealings and had recommended the stock to Murphy, he had made a "solicitation of an offer to buy" the South American Utilities stock and so was a "person who . . . sells a security."

This, it is submitted, strains the definition beyond its reasonable meaning. It is not unusual for someone who has something which he wishes to sell to approach a prospective purchaser and ask him to make an offer to buy. Such a request is not strictly an offer of sale, although it may result in a sale quite as much as a straight offer of sale. It is a part of the negotiation of the contract of sale and consequently is something reasonably to be included in the sort of definition contained in Section 2. The intent of Section 2 was to prevent a person who has sold a security from saying: "I never offered to sell, I got the buyer to make me an offer which I accepted. You cannot hold me on any offer." That section also is concerned with the seller-buyer relationship and it is designed to cover all aspects of that relationship, but no more.

Four terms are defined: (1) sale, (2) sell, (3) offer to sell, and (4) offer for sale. There are also four definitions: (1) contract of sale, (2) disposition of, (3) attempt or offer to dispose of, and (4) solicitation of an offer to buy. The two groups obviously are designed to be in balance and "solicitation of an offer to buy" is set against "offer for sale." The definition is designed to include every action which a seller could take through which title would pass from him to the buyer. It accomplishes this design, but it endeavours to do no more.

It may be that the decision of the District Judge arose from a confusion between the expressions "soliciting an offer to buy" and "soliciting an order to buy." What the broker ordinarily does with his customer is to solicit the customer's *order* to buy for the customer's account. This is not the same thing as soliciting an *offer* to buy. The only person who can truly solicit an *offer* to buy is the offeree or the offeree's agent, that is to say, the prospective vendor. A broker who solicits authority from a customer to buy a certain security for the latter's account is *not* a person who solicits an *offer* to buy a security. Of course in ordinary speech no one would think of saying that he had given an *offer* to buy a security to his own broker. What a customer who has decided to buy a security gives to his broker is an *order* to buy. Here what Rhoades & Company solicited from Murphy was an *order* to buy and *not an offer* to buy.

This does not mean, of course, that brokers may not solicit offers. It merely means that a broker does not solicit an offer to buy from his own customer. A broker who buys securities for a customer does not sell them, whether his authority to buy be solicited or not.

Apart from the statute this proposition is amply supported by authority. Note particularly *Gill* v. *Hornblower*, 294 Mass. 26.

In that case the applicable statute (Massachusetts General Laws [Ter. Ed.] c. 110A, sec. 2(d)) provided:

> " 'Sale' or 'sell' shall also include an attempt to sell, an option of sale, a solicitation of a sale, a subscription or an offer to sell, directly or by an agent, or by a circular, letter, advertisement or otherwise."

It was held that a broker to buy securities did not sell them within the meaning of the statute.

The Court said, in part:

> "In ordinary speech, the transaction in question would not be described as a 'sale' of stock by the defendants to the plaintiff's testatrix. Rather, the defendants were her agents to buy stock" (p. 28).

See also—

Campbell v. *Willis*, 290 Fed. 271, 274 (App. D.C.).
Markham v. *Jaudon*, 41 N.Y. 235, 244.
Fowler v. *N.Y. Gold Exchange Bank*, 67 N.Y. 138, 143.
Rice v. *Winslow*, 180 Mass. 500, 502, 503.
Chase v. *Boston*, 180 Mass. 458.
Post v. *Leland*, 184 Mass. 601.
Prince v. *Scura*, 272 N.Y.S. 362.

The nature of the act performed by a broker who buys for the account of a customer is, of course, in no way altered by the manner in which the broker obtained his authority, whether by solicitation or otherwise. If authority were bestowed without solicitation, it would not be claimed that the broker was a selling agent; it would be clear that he was an agent to buy only. But, if the broker does solicit his authority, does he cease to be a buying agent and become a selling agent only, for the purposes of the statute at least? Or is he both a buying and a selling agent, and, if so, does he as buying agent buy from himself as selling agent?

Such theoretical difficulties result because solicitation of an *order* to buy securities is treated as identical with solicitation of an *offer* to buy securities. When the natural distinction between the words is regarded, it is clear that one who solicits an *order* to buy does not sell.

It is not to be inferred that Congress used the words "order" and "offer" interchangeably and without recognizing any difference in meaning.

B. The respondent did not purchase the securities from the petitioners.

Furthermore, applying the definition of Section 2 to Section 12, as the judge did, would not permit recovery in this case. It might bring the defendant within the eligible category of "any person who . . . sells a security," but it could not make the plaintiff into "the person purchasing such security from him." Murphy did not purchase from Rhoades & Company. A cause of action could accrue only to a plaintiff who brought himself within the definition, and that the plaintiff in this case has not done. It cannot be assumed that Congress chose the words just quoted by mistake. It would have been quite simple to use language which would impose liability for a negligent misrepresentation without a sale from the defendant. The language selected by Congress was in no way apt for that purpose. It must be construed as meaning what it specifically says —and not something else which might have been said but was not.

C. Section 12 contemplates rescission, impossible here.

Moreover, it is to be noted that Section 12 deals with rescission of a transaction. The primary right given to the defrauded purchaser is to rescind — to recover the consideration paid upon tender of the security. But rescission can only be between buyer and seller. It can never be enforced against an agent who did not have title.

McMillan v. *Arthur,* 98 N.Y. 167.
Connelly v. *Glenny,* 233 App. Div. 198.
Kinney v. *Glenny,* 231 App. Div. 311.
See also *Spiegel* v. *Beacon Participations, Inc.,* 297 Mass. 398, 418.

The result of rescission enforced by the courts must be a return to the *status quo.*

Houghton v. *Nash,* 64 Me. 477.
Sharp v. *Ponce,* 76 Me. 350.

If a purchaser could rescind against an agent, the result would not be a return to the *status quo,* but a novel transfer of title to the agent who never had it before.

See *Buck* v. *Carlisle,* 98 Ala. 580.

That Section 12 gives primarily a right to rescission is further emphasized by the fact that it gives the plaintiff a right "to recover the consideration paid for such security with interest thereon." Of course one can recover the consideration only from the person to whom it has passed. A buyer can recover the consideration only from the seller.

It is true that a right to damages likewise is given, but only where the buyer has parted with the security. The right to damages is obviously a secondary right given in a situation where the primary right of rescission would not be available. It adds nothing as far as the necessary relationship between the parties is concerned.

D. Section 12 must be strictly construed.

Finally, it must be remembered that the statute is one in derogation of the common law and so to be strictly construed.

Johnson v. *Southern Pacific Co.,* 117 Fed. 462, 466 (C.C.A. 8).
Globe & Rutgers Fire Ins. Co. v. *Draper,* 66 F. (2d) 985, 991 (C.C.A. 9).
Haggett v. *Hurley,* 91 Me. 542.
Howard v. *Howard,* 120 Me. 479.
Palmer v. *Town of Sumner,* 133 Me. 337.

It is submitted that there can be no escape from the construction which we urge in view of the language used in the section. Practical considerations of justice and hardship support the same construction and lead to the conclusion that Congress intended that construction to be adopted. The section imposes a heavy burden which it would not be reasonable to impose on a person not the owner of the security sold. If a person owns a security, *e.g.*, an issuer or underwriter, and desires to sell it, there are strong reasons for holding him to a strict standard as is done by this statute. But with the broker the situation is wholly different. On any brokered sale he can gain no more than a small commission.

In the present case the entire financial gain to Rhoades & Company from negotiating the purchase of the stock by Murphy was the net commission of $34 (Rec. pp. 135, 186, 187). The broker is not subject to the same temptation as the owner to misstate the facts. If an owner fails to consummate a desired sale, he may lose his entire investment or a material part of it. The broker, on the other hand, can lose nothing. He may not receive a commission which he might otherwise earn, but he can be no worse off than he was before. It is a matter of indifference to him whether his customer buys security A or security B. Any variation in the commission would be insignificant. But to the owner of security A it is vital that the customer buy that and not security B which someone else owns.

It is considerations such as these which have led state courts to construe state statutes similar to the Securities Act as not applicable to brokered transactions.

See *Gill* v. *Hornblower*, 294 Mass. 26.

The suggestion made by Judge Peters that the defendants although brokers are to be held liable by reason of extra-brokerage activities cannot be reconciled with the proper construction of Section 12. The judge said:

> "The ordinary brokerage transaction, merely the execution of orders to buy or sell, does not appear to be affected by Section 12. It is the extra-brokerage activity,—solicitations accompanied by false statements, —which are made the basis for a cause of action if damage is caused thereby" (Rec. p. 291).

The question is not whether the section can ever apply to any broker. Obviously it can and does where the broker owns the security and himself sells it. Rather it is whether the section can apply to anyone but an owner or his agent. Certainly the actual language of the section itself says nothing about imposing liability upon a person who does not sell because he does not own. Neither does the definition of Section 2 so enlarge it, and if it did, it still would not suffice, since that definition could have no application to the words, "person purchasing such security from him." If the section had said that any person who should make a false representation concerning a security should be liable to the person who bought the security on the strength of that representation, this appeal never would have been taken. But that is not the provision of the section. The words used by Congress are apt to apply only to a dispute between buyer and seller. The respondent did not buy from the petitioners, and consequently, we insist, the statute can have no application.

Mention is made in the petition of the fact that this case has been made the subject of a special release by the Securities and Exchange Commission and has been commented on in the Wall Street Journal in a special article published in its issue of Tuesday, September 3, 1940. There is general concern in the brokerage profession lest a statute designed to protect the purchaser of securities against fraud or negligence on the part of issuers and dealers be construed as imposing heavy risks in the conduct of the ordinary brokerage business.

The District Judge's distinction between the "ordinary brokerage transaction" and "extra-brokerage activity" (Rec. p. 291) will scarcely bear scrutiny. No broker can conduct his business without giving information to his customers on the telephone. Under this decision every customer in New Jersey who places orders with a New York broker can recover from the broker the purchase price of any security which he may buy, provided that he can induce a jury to believe that the broker said something on the telephone which turned out not to be so, or, even worse, failed to tell the customer something he would have considered material.

How the brokerage business might reorganize to protect itself against this decision cannot be predicted. Without being unduly pessimistic we may well ask why responsible persons should take the risk of losing the full purchase price of securities or a substantial part thereof, when the only possibility of gain is a fraction of one per cent of the purchase price. The rule laid down by the District Court applies not only to transactions on the open or counter market, but to those on exchanges as well. It applies also not only to an untrue statement of a material fact, but to the omission to state a material fact. Whether or not a fact not stated is to be deemed "material" must always be a nice question, but the broker's customer can always testify that he was influenced by the non-disclosure. If Congress had had any intention of imposing revolutionary changes on the commission business, it would certainly have expressed this intent explicitly in the Act, and not left it to implication from a strained and quite unnecessary construction of the statutory definition of the word "sell."

Respectfully submitted,

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